

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
REPLY BRIEF**

ORIGINAL
WITH PROOF
OF SERVICE

74-1795

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P/S

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

GEORGE J. SCHONHOLTZ,

Plaintiff-Appellant,

- against -

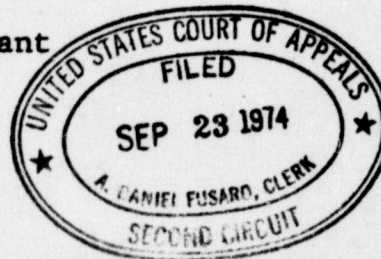
AMERICAN STOCK EXCHANGE, INC., RAMSAY RE, FARRELL,
ROCHLIN & ERDMAN and BEAR STEARNS & CO.,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF THE APPELLANT

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 74-1795

GEORGE J. SCHONHOLTZ,

Plaintiff-Appellant,

-against-

AMERICAN STOCK EXCHANGE, INC.,
RAMSEY, RE, FARRELL, ROCHLIN
& ERDMAN and BEAR, STEARNS & CO.,

Defendant-Appellees.

Appeal from the United States District Court for the
Southern District of New York

REPLY BRIEF OF THE APPELLANT

STATEMENT

Plaintiff submits this memorandum in reply to the
answering memoranda submitted by the defendants. Although
plaintiff contends that the defendants are in error in many

respects, he has limited his reply to those errors he considers most significant.

POINT I

PLAINTIFF HAS ALLEGED AN ACTIONABLE
DUTY UNDER THE AMEX RULES

Defendants seek to disavow their express duty to ensure that investors trade in an orderly market. In so doing, they attempt to portray themselves as persons of restricted function and limited discretion. In order to achieve such a result, defendants have distorted plaintiff's claim with respect to the inadequate "float" of Levitz stock, erroneously equating the number of shares publicly held with the number of shares actually available for trading.

Defendants contend that since Levitz met the numerosity requirements of public ownership, no basis existed for suspending trading. They fallaciously cite in support of their position the delisting policies of the American Stock Exchange (AMEX) which provide that it "may at any time, and without notice, suspend dealings ... in any security." Defendants point to one of the guidelines adopted by the AMEX to assist in the application of delisting policies.* Such guideline indicates that the AMEX will give consideration to suspending trading in a security whose publicly held shares number less than 200,000. Defendants' reliance upon

* 2 CCH American Stock Exchange Guide ¶10,051.

this guideline as a defense to this action is misplaced for two reasons:

(1) Condition 2(a), cited by defendants, refers only to public distribution of stock and is irrelevant to a suspension of dealings because of inadequate trading supply. The number of shares held by the public and the number of shares available for trading are not identical species. Although a stock may be held by the public in sufficient quantity to permit an orderly market under ordinary conditions, unusual factors may result in the creation of a "corner."

(2) AMEX policy provides that it may suspend dealings in a security "when in its opinion such security is unsuitable for trading on the Exchange ... regardless of whether the issuer meets or fails to meet the conditions discussed below."* Such conditions, which need not be met for suspension, include 2(a). Accordingly, the AMEX can suspend trading in a security regardless of its public ownership, when trading in such security becomes "unsuitable."

Thus, the AMEX, itself, makes plain that its guidelines do not furnish an exclusive basis for the suspension of trading. Clearly, its policy with respect to the number of shares of a publicly held security does not preclude the suspension of trading in that security where, as herein, the

* 2 CCH American Stock Exchange Guide ¶10,051.

number of shares actually available for trading is so small that a corner in the stock exists.* Accordingly, the statement of defendants Ramsey, Re and Bear, Stearns that relevant policies of the AMEX provide that it "may suspend trading for reasons of 'inadequate float' only when the number of shares publicly held ... is less than 200,000"*** is totally untrue (emphasis added).

The fallacy of defendants' argument is further evidenced by the action of the New York Stock Exchange (NYSE) to which Levitz' listing was transferred after the transactions engaged in by plaintiff. The NYSE suspended trading in Levitz stock. ***

The defendants seek not only to circumscribe their discretion in suspending trading, but also to minimize the vital role played by specialists in the regulatory scheme to

* See A-15, A-16.

** Defendants-Appellees' Brief, p. 9-10.

*** Wall Street Journal, February 3, 1972, p. 7.
The Court may take judicial notice of this fact.
See Mamiye Bros. v. Barber S. S. Lines, Inc.,
241 F. Supp. 99 (S.D.N.Y. 1965), aff'd, 260 F.2d
774 (2d Cir.) cert. denied 385 U.S. 835 (1966).
For the Court's convenience, a copy of the article
is annexed as an appendix to this brief.

protect investors, claiming that they have little effect upon trading or prices. However, Senator Harrison A. Williams, Jr. has recently reaffirmed the importance of the specialist in the regulatory scheme:

"The stock exchange specialist stands at the heart of the auction market. In his dual capacities of broker and market maker, the specialist has an intimate connection with the trading process and is in a crucial position to affect both prices and the manner and speed of executing securities orders. Because he is subject to conflicts of interest and has trading advantages over other investors, effective regulation of the specialist is vital to the health of the auction market and to the confidence of public investors in the fairness of that market." *

The defendant specialists also contend that their duties are the province of the SEC and the Stock Exchanges. However,, an action for damages as sought herein for a breach of such duties can only be brought in the District Court.

Further, Senator Williams points out the failure of the Exchanges and the SEC to take effective action against delinquent specialists. ** The reluctance of the AMEX to take action against its own members in general and the control that specialists have over the enforcement policies of that Exchange indicate the need for private actions.

* Senate Securities Subcommittee Study of Broker-Dealers and the Role of Specialists in the Securities Industry. CCH Fed. Sec. L. Rep. ¶79,174 (1973).

** Ibid. .

POINT II

PLAINTIFF HAS ALLEGED AN ACTIONABLE DUTY UNDER §10(b) AND RULE 10b-5

Plaintiff has alleged that he was damaged by the failure of the defendant specialists and the AMEX to maintain an orderly market in Levitz stock and to suspend trading after such failure permitted a corner in Levitz shares to develop. Although[®] the duties of a specialist with respect to the maintenance of an orderly market are deemed "nonexistent" by the defendant specialists,* they were recognized as valid in Cutner v. Fried, ** in which the court upheld that part of a complaint against the NYSE and certain specialists based upon a violation of §10(b) and Rule 10b-5. The plaintiffs alleged, among other things, that the defendants had violated a rule of the NYSE which required them "as specialists to maintain a fair and orderly market and to minimize the effects of temporary disparities between supply and demand." The court found valid a complaint which pleaded a violation of Rule 10b-5, based upon an allegedly unjustified suspension of trading.***

Defendants also contend that the plaintiff has not sufficiently pleaded conduct amounting to fraud. However,

* Brief of Defendants-Appellees Ramsey, Re and Bear, Stearns, p. 19.

** CCH Fed. Sec. L. Rep. ¶94,432 (S.D.N.Y. 1974).

*** The court also granted class action status.

plaintiff submits that the alleged actions of the defendants herein, in permitting a disorderly market to exist, without disclosure, for such a protracted period, constitute "an almost callous disregard" of the AMEX Rules and "their purpose to protect the public."* Accordingly, he has sufficiently pleaded scienter so as to permit a determination on the merits.**

The AMEX contends that it is not liable as an aider and abettor under §10(b), since its alleged misconduct involved only a failure to act. However, in the recent case of Hochfelder v. Ernst & Ernst,*** the court held that a claim for aiding and abetting by inaction can be maintained by a showing that the party charged with aiding and abetting had knowledge of or, but for the breach of a duty of inquiry, should have had knowledge of the wrongdoing and failed to act due to a breach of the duty of disclosure. The conduct of the AMEX herein provides all the elements set forth by the court as required to state a cause of action under §10(b).

* Buttrey v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.
410 F.2d 135, 141 (7th Cir. 1969), cert. denied 396
U.S. 838 (1969).

** In the event this court concludes that the complaint is technically deficient, the record reflects that there is abundant evidence upon which full allegations of fraud, scienter and breach of duty can be made. Accordingly, at the very least, the court below should have permitted plaintiff leave to file an amended complaint.

*** CCH Sec. L. Rep. ¶94,781 (7th Cir. 1974).

CONCLUSION

Defendants' contentions are without merit. The judgment of the court below should be reversed.

Dated: New York, New York
September 20, 1974

Respectfully submitted,

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STATE OF NEW YORK)
COUNTY OF NEW YORK) ss.:

Robert La Grasso, being duly sworn,
deposes and says that deponent is not a party to the action,
is over 18 years of age and resides at 62-20 60' Rd
Maspeth, N.Y.

That on the 23 day of Sept, 1974
deponent personally served the within Reply Brief of the
Appellant
upon the attorneys designated below who represent the
indicated parties in this action and at the addresses below
stated which are those that have been designated by said
attorneys for that purpose.

~~By leaving true copies of same with a duly
authorized person at their designated office.~~

By depositing 2 true copies of same enclosed
in a postpaid properly addressed wrapper, in the post office
or official depository under the exclusive care and custody
of the United States post office department within the State
of New York.

Names of attorneys served, together with the names
of the clients represented and the attorneys' designated
addresses.

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Robert La Grasso

Sworn to before me this

23 day of Sept, 1974

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Bronx County 75
Commission Expires March 30, 1975